

**LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 6532

BILL NUMBER: SB 283

NOTE PREPARED: Jan 1, 2004

BILL AMENDED:

SUBJECT: Phaseout of Inheritance Tax.

FIRST AUTHOR: Sen. Ford

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill phases out the Inheritance Tax by giving an increasing credit against the Inheritance Tax due. It provides that the Inheritance Tax does not apply to the transfer of property interests from a person whose death occurs after June 30, 2008.

Effective Date: July 1, 2004.

Summary of Net State Impact: Under the bill the state will experience a progressively larger reduction in Inheritance Tax revenue from FY 2006 to FY 2010 when the state will no longer receive revenue from the tax. The bill could potentially lead to a slight increase in Estate Tax revenue in FY 2006. The bill is also expected to increase state General Fund expenditures on county Inheritance Tax replacement. The impact of the bill on state revenues and expenditures is summarized in the table below.

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2006	(\$20.3 M)	\$48,258	(\$1.8 M)	(\$22.0 M)
2007	(40.6 M)	0	(3.5 M)	(44.1 M)
2008	(60.9 M)	0	(5.3 M)	(66.2 M)
2009	(81.2 M)	0	(7.0 M)	(88.2 M)
2010 and after	(101.5 M)	0	(7.4 M)	(108.9 M)

Explanation of State Expenditures: *Department of State Revenue:* If the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff of the Inheritance Tax Section of the Department of State Revenue. The December 3, 2003, State Staffing Report indicates that the Inheritance Department has 15 full-time employees with an annual salary of \$464,528. Since staff will be needed to process returns during the phaseout of the Inheritance Tax, a specific savings due to staff reductions could not be estimated.

County Inheritance Tax Replacement: The bill could increase expenditures from the state General Fund for county Inheritance Tax replacement beginning in FY 2006 as specified in the table below. These calculations represent upper bounds, and necessary replacement amounts may vary depending on whether and by how much each county's base Inheritance Tax revenue differs from the amount guaranteed under current statute. After the elimination of the Inheritance Tax beginning July 1, 2009, the impact is estimated to total approximately \$7.4 M annually in FY 2010 and subsequent years.

Fiscal Year	State Expenditures for County Replacement
2006	(\$1.8 M)
2007	(3.5 M)
2008	(5.3 M)
2009	(7.0 M)
2010 and after	(7.4 M)

Explanation of State Revenues: The bill would lead to progressively larger reductions in Inheritance Tax revenues from FY 2006 through FY 2009 when the tax is completely phased out and would no longer generate revenue. The reduction in inheritance tax liabilities is expected to increase Indiana Estate Tax revenue slightly in FY 2006. (The Indiana Estate Tax equals the difference between Federal State Death Tax Credit and the Indiana Inheritance Tax. Consequently, as the Indiana Inheritance Tax decreases, the Indiana Estate Tax would increase.) The Estate Tax offset is expected to decline to zero in FY 2007 as the phaseout of the federal state death tax credit (began in 2002) is completed. The net revenue loss is shown in the table below.

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	Net Revenue Increase (Decrease)
2006	(\$20.3 M)	\$48,258	(\$20.2 M)
2007	(40.6 M)	0	(40.6 M)
2008	(60.9 M)	0	(60.9 M)
2009	(81.2 M)	0	(81.2 M)
2010 and after	(101.5 M)	0	(101.5 M)

Background on Inheritance Tax: The bill phases out the Inheritance Tax over a five-year period by providing an increasing credit against the transferee's Inheritance Tax liability. The credit would apply to transfers made by persons who die within the dates specified in the following table. Since the Inheritance Tax can be paid within 12 months after the decedent's death (within 9 months to receive the 5% early payment discount), the bulk of the impact of the first year's credit (equal to 20%) would not be experienced until FY 2006.

Inheritance Tax Credit	Transfers made from persons dying...
20%	After June 30, 2004, and before July 1, 2005
40%	After June 30, 2005, and before July 1, 2006
60%	After June 30, 2006, and before July 1, 2007
80%	After June 30, 2007, and before July 1, 2008
100%	After June 30, 2009

The estimated impact of the phaseout of the Inheritance Tax is based on the Revenue Technical Committee's FY 2004 forecast (updated April 10, 2003). The forecast estimates FY 2004 combined Inheritance and Estate Tax revenues to be \$120 M. Based on a four-year average (2000-2003), 84.6% of the forecast revenue is estimated to be attributable to the Inheritance Tax. From these estimates, the Inheritance Tax will yield about \$101.5 M, and the Estate Tax will yield about \$18.5 M in FY 2004. These revenue estimates are used as the base for the fiscal impact analysis.

Background on Estate Tax: The elimination of the Inheritance Tax would affect Estate Tax revenues. Under current statute, Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Under the bill the Indiana Estate Tax would still be limited to estates paying federal Estate Tax, but for some estates the Indiana Estate tax will increase as the Indiana Inheritance Tax decreases. As explained above, the federal Estate Tax is set to expire in 2005. As such, the revenue impact of the bill will affect the Indiana revenues only for FY 2006.

The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2004 Estate Tax forecast (updated April 10, 2003) of \$18.5 M. It is estimated that the estate tax revenue will decrease to \$596,000 in FY 2006 as a result of the phaseout of the federal state death tax credit. The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana Estate Tax. The phaseout of the Inheritance Tax

increased the Estate Tax liability of the sample by approximately 8.8% in FY 2006. As a result, the Inheritance Tax changes are estimated to increase Estate Tax Revenue by approximately \$48,250 in FY 2006.

Explanation of Local Expenditures:

Explanation of Local Revenues: The phaseout of the Inheritance Tax could result in an annual revenue loss to counties beginning in FY 2006.

Fiscal Year	Local Share of Inheritance Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2006	(\$1.8 M)	\$1.8 M	\$0
2007	(3.5 M)	3.5 M	0
2008	(5.3 M)	5.3 M	0
2009	(7.0 M)	7.0 M	0
2010 and after	(8.8 M)	7.4 M	(1.3 M)

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.3% of Inheritance Tax revenue is attributable to the resident Inheritance Tax. Based on the FY 2004 forecast of state Inheritance Tax revenue totaling \$101.5 M, annual county Inheritance Tax revenue will be approximately \$8.8 M beginning in FY 2004. Counties are guaranteed a statutorily determined amount as determined by the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years.

Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure. From FY 2000 to FY 2003, counties exceeded their guarantee amounts by an average of \$4.7 M annually with shortages subject to replacement totaling approximately \$204,886 per year. From the FY 2004 forecast, Inheritance Tax revenues to the counties are expected to total approximately \$8.8 M per year. The Inheritance Tax replacement that the state guarantees counties totals \$7.4 M per year. The above table shows the decrease in county revenues resulting from the bill. For FY 2006 through FY 2009, the reduction in local Inheritance Tax revenues is lower than the replacement amount, so the state would reimburse counties by this amount. The calculations for state expenditures for county replacement are upper bounds. Beginning in FY 2010 when the Inheritance Tax is phased out, the reduction in local tax revenues is larger than the guarantee amount and the decrease in county revenue after the replacement amount is paid is estimated to be \$1.3 M per year.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast (April 10, 2003), OFMA Inheritance Tax and Estate Tax databases.

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